Section II
Production

Chapter 12
LIHTC and other Tax Credit Program Guidance

12.1 Introduction

The Low Income Housing Tax Credit (LIHTC) program was enacted as part of the Tax Reform Act of 1986 and is administered by the Treasury Department and the State Housing Finance Agencies (HFA). In July 2008, the Housing and Economic Recovery Act (HERA) was enacted which made changes to FHA programs to facilitate the use of FHA-insured mortgages with LIHTC developments.

This chapter outlines the policies and procedures to follow when underwriting and reviewing FHA mortgage insurance applications referenced under Title II of the National Housing Act with tax credits. Standard processing of applications apply except as modified below as well as within Production, Chapters 5 and 11 of this Handbook.

All provisions of this Handbook applicable to LIHTC are also applicable to Historic and New Markets tax credit equity projects.

12.2 Program Guidance

A. **Use of Tax Credits with the FHA-Insured Mortgage:**

1. Government tax credits, combined with any secondary financing and grants, may be used to cover up to 100% of the equity requirement. Regarding secondary financing, see requirements and limitations in Production, Chapter 3, at 3.15.

2. Secondary financing, grants, and government tax credits may also be used to finance non-mortgageable costs. Such funds covering non-mortgageable costs, when added to the FHA-insured mortgage and required equity contribution, may exceed 100% of the project's Fair Market Value (FMV) or Replacement Cost.

3. Non-mortgageable costs or replacement cost items required to complete the project may be included in the application with supporting documentation, subject to ORCF approval.

4. Borrowers using LIHTC or other government tax credit programs must demonstrate successful experience in developing and owning comparable regulated properties.

5. If a tax credit syndicator is identified, the Lender's Underwriter will also need to provide a brief overview and analyses of the entity. Typically a tax credit syndicator is an investor intermediary with only a limited ongoing obligation to LIHTC rental properties. Accordingly, the syndicator's liquidity, track record, asset management and monitoring capability and ability to perform on its commitment to provide equity to the Borrower after Initial Closing is a material issue for the experience and creditworthiness analysis of the tax credit investor/LP.

6. For LIHTC projects with a funded working capital reserve held by the partnership (even though controlled by the syndicator or investor and not by HUD or the Lender), the funded reserve will be credited towards the increased construction reserve requirement, although the Lender controlled account must still meet the 2% working capital escrow requirement.

7. For LIHTC projects with a funded operating deficit reserve held by the partnership (even if controlled by the investor and not by HUD or the Lender), the funded reserve will be credited towards the reserve requirements of the mortgage, although the Lender controlled account must still meet what the appraisal and underwriting analysis determines to be an appropriate operating deficit amount.

B. **Tax Credit Equity Bridge Loans:**

1. Tax credit equity syndicators or investors (with or without an Identity of Interest with the Lender) may make equity bridge loans to LIHTC, Historic or New Markets Tax Credit projects during the construction or substantial rehabilitation period before the property's placed-in-service date. The bridge loan may be evidenced by a promissory note from the sponsor and may be secured by a pledge of the tax credits or of the limited partnership interest but may not be secured by a lien on the real estate. After the placed-in-service date, the bridge loan must be released and retired by the pay-in of the investor's equity.

   An equity bridge loan is a means of securing the sponsor's cash contribution that is required to complete construction before the LIHTC's are available to be claimed by the equity investor. The placed-in-service date is the date when the newly constructed or rehabilitated property has been completed and its units have been occupied by income qualified tenants. This is also when the LIHTC are officially able to be claimed by the equity investor, and is evidenced by issuance of IRS form 8609. The placed-in-service date will typically be after Final Closing of the mortgage. However, at Final Closing, all funds needed to meet the sponsor's cash contribution must be in the transaction so the sources and uses will balance and the LIHTC investors will pay in the equity to retire the equity bridge loan at the later placed-in-service date.

C. **Tax Credit Equity Contribution:**

1. ORCF requires that an appropriate amount of the tax credit equity be invested in the project and be applied to ORCF-approved items at the time of initial closing. The amount deemed by ORCF to be sufficient for such purposes will depend on the circumstances of each transaction, but must be an amount that assures an ongoing relationship between the Borrower and the tax credit syndicator or investor.

2. The initial installment of equity must be an amount that is equal to or exceeds twenty percent (20%) of the total equity that will be available for the project. If less than 20% is proposed, the Lender must submit a request for ORCF review and approval. ORCF will review the justification submitted to determine if the lesser amount is appropriate as an initial investment of equity.

3. The Commitment for Mortgage Insurance will contain, among other special conditions, a requirement for evidence satisfactory to ORCF of an agreement that binds the investor to timely and periodically pay the Borrower tax credit equity to contribute to the completion costs, in the aggregate amounts shown on the Applicant/ Recipient Disclosure/Update Report (Form HUD-2880). For example, a contribution schedule might require the 2^{nd} installment of LIHTC Equity to be contributed at 50% construction completion, the 3^{rd} installment at 75% construction completion, a 4^{th} installment required to complete construction and pay third party soft costs, exclusive of developer’s fee, by 90% construction completion, with the final infusion of LIHTC Equity, which contains any deferred developer’s fee, after 12-24 months of sustaining occupancy.

4. The actual amount of the initial equity investment must be reflected in the Firm Commitment as a special condition with the requirement that the initial installment must be expended on the initial requisition at Initial Closing.

5. After the first installment of LIHTC Equity is distributed at initial closing, the subsequent contributions shall be made at a time and in a manner during construction to ensure that the underwriting requirements in the Firm Commitment are maintained and met for actual costs. To maintain the appropriate balance of LIHTC Equity and mortgage loan proceeds, at each infusion of LIHTC Equity those funds may need to be utilized before the next disbursement of mortgage loan proceeds.

D. **Sponsor’s Continuing Commitment:**

1. In the case of LIHTC or Historic Tax Credit transactions, the application must include a *Letter of Commitment* to fund the required equity from a tax credit equity syndicator or investor. This *Letter of Commitment* must specify the equity amount, pay-in schedule and other relevant details such as conditional benchmarks so that HUD and the Lender can ensure sufficient equity in a manner that meets HUD's requirements.

The Lender may also make the determination to require additional documentation (e.g. financial statements, etc.) of a syndicator or investor.

2. The Lender must focus on and evaluate the LIHTC syndicator's or the direct investor's financial strength, experience, reputation and asset management capabilities, if they have the majority ownership interest in the Borrower entity. Evaluating the syndicator is important because investors expect syndicators to support transactions that have cash flow problems or replace nonperforming general partners. In addition, the syndicator must typically assess the appropriate amounts of reserves at both the property and fund levels and must perform certain asset management functions.

E. **Identity-of-Interest:** An affiliate of the Lender can be the tax credit equity syndicator or investor and can own up to a 25% percent interest in the 99% investor limited partnership (or an equivalent percentage if owned as an LLC) entity of the Borrower, under the following conditions:

1. In all instances where there is an identity of interest or affiliation between the Lender and the tax credit equity syndicator or investor: a) the loan must be processed, underwritten and approved by the Lender staff without involvement by the affiliated equity staff.

2. The affiliated tax credit equity syndicator or investor can hold no more than a 25% interest in the limited partnership entity (or an equivalent percentage if owned as an LLC) of the Borrower after the project's placed-in-service date. During the construction or rehabilitation period before the property's placed-in-service date, the tax credit equity syndicator or investor may make an equity bridge loan to the project that may be evidenced by a promissory note from the sponsor, which may be secured by a pledge of the tax credits or of the limited partnership interest but which may not be secured by a lien on the real estate. After the placed-in-service date, the affiliated tax credit equity syndicator or investor may not hold an equity bridge loan note and may not own more than a 25% interest in the limited partnership entity of the Borrower.

3. ORCF must ensure that the affiliated tax credit equity syndicator or investor does not improperly influence the Lender on a LIHTC project. Therefore, the Lender and the affiliated tax credit equity syndicator or investor must provide ORCF with a specific Representations and Warranties on applications submitted for each LIHTC project.

    a. **The Lender's Representation and Warranty must state:**

        i. No officer or employee of ________________________ (insert the name of affiliated tax credit syndicator or investor) or any director or parent thereof will have any loan-specific or decision making control or influence in ________________'s (insert the name of Section 232 Lender) underwriting of the FHA-insured mortgage except by providing factual information to _____________________ (insert the name of Lender) in the same manner as would be provided by an unaffiliated syndicator).

ii. _________________________ (insert the name of Lender) will not condition its agreement to provide such financing on ______________ (insert the name of affiliated tax credit equity syndicator or investor) being selected as the tax credit equity syndicator or investor for the project to be financed by the FHA-insured mortgage.

iii. ___________________ (insert the name of the Lender) will notify HUD promptly, in writing, during application processing of any change or event which causes the foregoing Representation or Warranty to be materially untrue or inaccurate.

b. **The Lender's affiliated tax credit syndicator or investor's Representation and Warranty must state:**

  i. In the regular course of its business it syndicates or invests in tax credit equity investments in assisted living affordable housing projects.

  ii. With respect to any project loan that is to be underwritten by _________________(insert name of Lender) and in which _______________(insert name of affiliated tax credit equity syndicator or investor) intends to make an equity investment or sell equity to other investors:

    1. No officer or employee ________________(insert name of Lender) will have any loan-specific control or influence in _____________________'s (insert name of affiliated tax credit equity syndicator or investor) processing of the sponsor's application for tax credit equity syndication or investment except by providing factual information to ___________ (insert the name of affiliated tax credit equity syndicator or investor) in the same manner as would be provided to an unaffiliated Lender.
    2. ___________________ (insert the name of affiliated tax credit equity syndicator or investor) will not condition its commitment to syndicate or invest in the project equity on debt financing for such project being provided by ___________ (insert the name of Lender).
    3. Except during the interim period prior to the placed in service date during which _______________ (insert name of affiliated tax credit equity syndicator or investor) may make an equity bridge loan to the project, neither __________________ (insert the name of affiliated tax credit equity syndicator or investor) nor any affiliate or subsidiary thereof will hold greater than a 25% interest in the 99% investor limited partnership entity (or an equivalent percentage if owned as an LLC) of the Borrower.

4. The Representations and Warranties must include the following criminal warning language: **WARNING**: *"HUD will prosecute false claims and statements.*

Convictions may result and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802)"

E. **Subsidy Layering Review:** Tax Credit equity solely in combination with FHA-insured debt is exempt (by the Housing and Economic Recovery Act of 2008 (HERA)) from a subsidy layering review. Beyond the FHA-insured debt, a subsidy layering review is required when other public funds are combined. In every case, regardless of the sources of supplemental public grant, loan, or equity funds, the Lender must review the Sources and Uses statements for both mortgageable and non-mortgageable funds to ensure costs are not being funded twice, and that costs funded directly or indirectly from mortgage proceeds are appropriate and necessary to complete the transaction.

12.3 Firm Commitment and Initial Closing

A. The Firm Commitment will include special Firm Commitment conditions to confirm and assure the Tax Credit Equity requirements stated in Section 12.2:

1. That the Commitment is subject to, and has been issued upon the reliance of, the receipt of Low Income Housing Tax Credit (Historic Tax Credits or New Market Tax Credits) syndication funds in the amount of $ of which a $ cash investment is required for mortgageable items including land and $ for HUD required escrows. The initial installment of funds allocated to mortgageable items must be provided prior to initial closing, with a disbursement agreement that evidences the timely infusion of funds required to pay for all project costs. All documents relating to the tax credit funds, including the Land Use Restriction Agreements, the final statement of sources and uses, and the final Applicant/ Recipient Disclosure/Update Report, must be reviewed and approved by ORCF prior to initial closing.

2. HUD's review and determination of acceptability and sufficient financial capacity is required for the tax credit investor(s). This investor entity and all principals are subject to Previous Participation clearance requirements, except to the extent limited liability corporate investors may submit an LLCI certification in lieu of other previous participation requirements. HUD approval of the final investor(s) must be accomplished prior to initial closing.

3. The Borrower's organizational documents must include a provision that prohibits any changes to the organization documents that affect the investor commitment without the written consent of the Lender and HUD.

B. **Initial Closing:** Prior to initial closing, HUD will review and approve all proposed closing documents to ensure compliance with all firm commitment obligations and Special Conditions. Specific to loans involving tax credits, the initial closing documents must include:

1. A final detailed Sources and Uses statement of total development costs, reflecting any revisions to hard and soft costs as reflected on the firm commitment, HUD-92264a-ORCF. If any funding sources have changed, a revised Applicant/ Recipient Disclosure/Update Report is also required.

2. Tax credit syndicator and investor documents. The Partnership Agreement or other investor documents of the syndicator, including:
    a. Consolidated Certifications,
    b. Previous Participation certifications,
    c. Modified credit package to include current financial report or Annual Report, as applicable.

3. Evidence that the FHA-Insured Mortgage will be in first lien position with respect to all project collateral.

4. All documents shall include conflict language giving the HUD documents supremacy over other documents. Documents may not include indemnification provisions, except as otherwise permitted by outstanding HUD guidance.